# GSTR 1999/D14 - Goods and Services Tax: apportionment of input tax credits for providers of financial supplies

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There is an Erratum notice for this document.
This document has been finalised.

# Draft Goods and Services Tax Ruling
Goods and Services Tax: apportionment of input tax credits for providers of financial supplies

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***Preamble***

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers and practitioners, as it is not a ruling or advice in terms of section 37 of the* ***Taxation Administration Act 1953****. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

## What this Ruling is about

### Class of person/arrangement

1. This Ruling sets out what the Commissioner considers to be acceptable apportionment methodologies for calculating input tax credits by providers of **financial supplies** under the *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). Unless otherwise stated, all legislative references in this Ruling are to the GST Act.

2. The Ruling also explains the way in which the **reduced input tax credit** provisions in Division 70 of the Act interact with the apportionment calculation.

3. Certain terms used in this Ruling are defined or explained in the Definitions section of the Ruling. These terms, when first mentioned elsewhere in the body of this Ruling, will appear in **bold** type.

4. This Ruling affects all entities, that are registered or required to be registered, that make financial supplies that exceed the **financial supplies threshold** and who may be eligible for input tax credits or reduced input tax credits.

5. Under subsections 11-30(5) and 15-25(4),[1] the Commissioner proposes to make a determination of an appropriate apportionment methodology to assist providers of financial supplies to work out the amount of input tax credits they are entitled to for their acquisitions and importations.

6. This Ruling does not cover the requirements for input tax credits generally and does not examine what is or is not a financial supply. We will address these issues in further GST public rulings, other publications or determinations. Draft GST Ruling GST 1999/D8 deals with apportionment methodologies for acquisitions or importations relating to making taxable supplies, or other input taxed supplies such as residential accommodation.

7. This Ruling does not specifically address methodologies to be used when the intended use of an acquisition or importation changes, such as 'asset tracking'. However, the methodologies outlined in this Ruling will apply to allow the correct calculation of later adjustments for change in use of an acquisition or importation. Where use changes, entities must make the appropriate adjustment to reflect that change.

## Date of effect

8. This Ruling, when finalised, will apply on and from 8 July 1999 (the date of Royal Assent to the Goods and Services Tax ('GST') legislation).

## Background

9. If you are a **financial supply provider** you may make a mixture of taxable, GST-free and input taxed supplies. Under Divisions 11 and 15, you are not entitled to input tax credits to the extent you acquire or import goods, services or anything else to make input taxed supplies.

10. An acquisition will be partly creditable under subsection 11-30(1) where:

- the acquisition is only partly for a creditable purpose; or
- you provide or are liable to provide only part of the consideration.

[1] Subsections 11-30(5) and 15-25(4) are amendments contained in the *A New Tax System (Indirect Tax and Consequential Amendments) Bill No 2.*. This Bill received Royal Assent on 22 December 1999.

Under subsection 15-25(1), an importation is partly creditable if it is only partly for a creditable purpose.

11. An acquisition or importation is partly creditable (rather than fully creditable) under sections 11-15 and 15-10 where you use it to make input taxed supplies or for a private or domestic purpose. Sections 11-15(4) and 15-10(4)[2] operate so that an acquisition or importation is not regarded as being partly creditable where it relates to making financial supplies that are below the financial supply threshold. This means that input tax credits are available for GST paid on the acquisition or importation, despite the acquisition or importation being used to make financial supplies that are input taxed.

12. If you make financial supplies that exceed the financial supplies threshold, then you will not be entitled to input tax credits for things acquired or imported to the extent they are used to make financial supplies. However, you may be entitled to reduced input tax credits if those acquisitions are **reduced credit acquisitions** as specified in regulation 70-2 of the *A New Tax System (Goods and Services Tax) Regulations 1999* ('the GST Regulations').

13. If you use the acquisition you acquire or importation you import in carrying on your enterprise to make financial supplies (and other input taxed supplies), then you will be entitled to a partial input tax credit to the extent that the acquisition or importation is for a creditable purpose. We cover methods for determining the extent of your creditable purpose when you do not make supplies exceeding the financial supplies threshold in greater detail in draft GST Ruling GSTR 1999/D8.

14. Under subsections 11-15(4) and 15-10(4), if your annual turnover of financial supplies does not exceed the financial supplies threshold, and all your other supplies are taxable or GST-free, your acquisitions can still be fully creditable. However, if:

(i) your annual turnover of financial supplies does not exceed this threshold; and

(ii) you make other input taxed supplies, or acquisitions of a private or domestic nature,

you still need to apportion your input tax credits to the extent that you use your acquisitions or importations in making those other input taxed supplies or they are of a private or domestic nature.

15. We use the definitions of financial supply provider and **financial supply facilitator** to avoid confusion between the provision of the actual financial supply and another supply made to arrange or facilitate that supply (such as agency services). For example, if A

[2] Amendment contained in the *A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999.* This Bill received Royal Assent on 22 December 1999.

sells shares to B but does so through X, an agent, A is making the financial supply of the shares to B and X is making the supply of agency services. The financial supply is input taxed, while the agency services are taxable.

16. The financial supply facilitator is an entity that facilitates the supply of an interest in a financial product without being the financial supply provider of that interest. Supplies made in the capacity of a financial supply facilitator are not financial supplies made by the financial supply facilitator.

## Ruling

17. The Commissioner may under subsections 11-30(5) and 15-25(4), determine one or more ways in which to work out, for the purposes of subsections 11-30(3) and 15-25(3), the extent to which an acquisition or importation is for a creditable purpose.

18. The Commissioner proposes to make the following determination under subsections 11-30(5) and 15-25(4).

19. Where you make an acquisition or importation in carrying on your enterprise and you use it partly for making input taxed supplies, you will need to apportion any input tax credits for those acquisitions or importations. Input tax credits are denied for acquisitions or importations to the extent that you use that acquisition or importation to make input taxed supplies. However, you may be entitled to reduced input tax credits if those acquisitions are **reduced credit acquisitions** as specified in regulation 70-2 of the GST Regulations. (See paragraph 12.)

20. We recognise that, from a practical point of view, it may be impossible to fully apportion individual costs in many organisations. We do not expect financial supply providers to match individual costs to individual revenue streams. This is the reason for permitting an apportionment methodology. (See paragraph 14.)

21. The apportionment method you choose should reflect, as closely as possible, your use of an acquisition or importation in carrying on your enterprise and consequently your related entitlement to input tax credits for that acquisition or importation. (See paragraph 31.)

22. Apportionment methodologies that the Commissioner accepts as reasonable are:

- the direct attribution method; and
- the general formula (or an appropriate alternative formula).

Some entities may need to use a combination of the two methods. (See paragraph 33.)

23. The Commissioner requires that you use the direct attribution method to the greatest extent possible. If you already use cost allocation or direct attribution as part of your entity's accounting processes then we expect you to use this for apportionment purposes to the extent it is relevant for GST. (See paragraph 45.)

24. Acceptable methods for apportionment are:

- direct attribution;
- direct attribution plus the general formula (or an appropriate alternative formula) for unallocated costs; or
- general formula method (or an appropriate alternative formula) where direct attribution has been used as far as possible.

(See paragraph 44.)

25. You should use the method chosen consistently between GST periods, including throughout the year and from year to year. You should only change the basis used to apportion input tax credits where the method used is no longer appropriate and no longer accurately reflects how you are to use acquisitions or importations.

26. Circumstances where we will accept a change in the apportionment method include:

- a restructure or significant change in the business activities of the entity; or
- modification of the entity's accounting system or installation of new financial accounting systems.

(See paragraphs 38 to 40.)

27. You should retain documentation that shows and explains all transactions that are relevant to the input tax credits you claim for acquisitions or importations you make. The records you keep should provide evidence of the basis for the calculation used and any working, such as how you arrived at particular figures used. (See paragraphs 91 to 92.)

28. The apportionment methodology you choose should be appropriate, reasonable, used consistently and supported by documentary evidence. Where all these elements are present, we will not consider the fact that you choose the method that gives the most advantageous result, of itself, to be avoidance under Division 165. (See paragraph 36.)

# Explanations (this forms part of the Ruling)

**Methodologies for apportioning input tax credits**

29. Where an entity's annual turnover of financial supplies exceeds the financial supplies threshold, no input tax credit is available to the extent you acquire or import an acquisition or importation for use in making financial supplies.

30. Where you make an acquisition or an importation in carrying on your enterprise and it relates to making input taxed supplies, you will need to apportion any input tax credits for those acquisitions or importations. Input tax credits are denied for acquisitions to the extent that you use the acquisition to make input taxed supplies.

31. The apportionment method chosen should reflect as closely as possible the entity's use of that acquisition or importation and consequently the entity's related entitlement to input tax credits for that acquisition or importation.

32. The measure for this will be what the impartial, but informed, observer would regard as reflecting as closely as possible the use of that acquisition or importation. However, the method that is the most appropriate for determining the extent to which you use an acquisition or importation in making a supply will depend on the circumstances of each case.

33. Apportionment methodologies which the Commissioner accepts as reasonable are the direct attribution method, the general formula and a special formula method. Some entities may need to use a combination of the direct attribution method together with one of the formula methods.

34. The Commissioner requires that you use the direct attribution method to the greatest extent possible. If the accounting system you use satisfies Australian Accounting Standards, the Commissioner will generally accept it as being a reasonable basis for direct attribution.

35. Entities should only use the general formula where they have used the direct attribution method as far as they are able. If an entity already uses a cost allocation or direct attribution approach as part of their accounting processes then we expect them to use this for apportionment purposes to the extent it is relevant for GST.

36. The Commissioner will accept use of the general formula or another appropriate formula to allocate costs within the direct attribution method. The formula method you use must:

- be appropriate, reasonable and used consistently;
- accurately reflect the use of that acquisition; and
- be well documented and justifiable.

37. If you do not use an acceptable direct attribution system for internal accounting purposes, it will be appropriate for you to use the general formula or some similar formula that complies with the requirements set out at paragraphs 55 to 78 below.

38. You should use the method you choose consistently throughout the year and from year to year. This means we expect that you would use the same methodology on a continuing basis. You should only change the basis used to apportion input tax credits where the method used is no longer appropriate and no longer accurately reflects how you use and/or acquire acquisitions or importations.

### *Changing your apportionment method*

39. Events that would justify a change in the method used include a restructure of the entity or a significant change in the business activities of the entity. We will also accept a change in method used where an entity installs new financial accounting systems (including management accounting systems or activity based costing systems) or modifies their existing accounting system to a more accurate and direct system.

40. If you want to change the method you use but you are unsure whether you have grounds for changing to a different basis, you should approach the Commissioner to obtain approval for that change. However, if the reason you want to use a new method meets the criteria outlined above and at paragraph 33, then there is no need for you to seek the Commissioner's approval to make that change.

### *Apportionment of 'enterprise costs'*

41. You make an acquisition or importation in 'carrying on your enterprise' once it is established that you made the acquisition in the course of the activity or series of activities that constitute your enterprise.

42. Certain acquisitions or importations relate to the carrying on of the enterprise and are not necessarily linked to the making of any supplies. These may be referred to as 'enterprise' costs and may include costs such as compliance costs for meeting ASIC, GST or income tax obligations, or maintaining a register of shareholders. These may still be creditable acquisitions provided you made them in carrying on your enterprise.

43. However, if you make input taxed supplies as well as taxable supplies or GST-free supplies, you will still need to apportion the input tax credits on these types of acquisitions and importations.

## Choosing an appropriate method

44. Apportionment methods which are suitable to work out your entitlement to input tax credits are:

- direct attribution;
- direct attribution together with a formula (either general or another appropriate 'special' formula method); and
- general formula (or another appropriate 'special' formula method).

45. You must directly attribute your costs to the greatest extent possible before using a formula method to allocate your other costs. You can then use the general formula or a special formula method to allocate your remaining costs.

46. Special formula methods discussed in this Ruling are:

- special allocation method which is an industry based method; and
- input based method which is an indirect method that employs measures of some inputs to estimate the use of other inputs.

47. You should take the following approach in working out which method(s) to use to apportion costs:

**Step 1** – if you already have a system allowing direct attribution, use that method to directly attribute and allocate costs to the greatest extent possible; and

**Step 2** - use the general formula (or some other appropriate formula) to determine the recovery ratio for your remaining unallocated costs.

## Direct attribution

48. The direct attribution method matches specific costs with specific outputs as well as the allocation of mixed purpose costs to specific outputs in accordance with the internal cost allocation system. For example, the system you use may allocate costs to a specific:

- transaction;
- product line;
- function or activity;
- cost or profit centre; or
- business division.

These are referred to, for simplicity, as business units and products - generally the lowest functional area into which an entity is organised.

49. For example, an entity might use an existing accounting system that uses activity based costing or some other internal cost allocation system to allocate costs to a specific cost centre.

50. The direct attribution method therefore involves specifically matching the cost of certain sole purpose acquisitions or importations to certain specified activities. It also involves the allocation of a proportion or proportions of the cost of mixed purpose acquisitions or importations to those activities. For example, overheads such as electricity and rental of premises will often relate to all supplies made by an entity and will need to be apportioned accordingly.

### Combination of direct attribution with formula

51. We recognise that internal cost allocation systems will not necessarily allocate all costs. For the remainder of unallocated costs, you may use a formula basis to allocate the costs to outputs.

52. You may attribute unallocated costs using the general formula (as outlined at paragraphs 55 to 78) or a special formula that more accurately reflects the ratio of input taxed to taxed activity for the particular entity or part of the entity. That is, you may use another formula if it provides more appropriate cost recovery. We will accept a combination of direct attribution and the formula for apportionment.

53. You may also use the general formula where a cost centre relates to taxable, GST-free and input taxed supplies and you have used the direct attribution approach to the greatest extent possible. That is, where the lowest level of the entity's cost accounting system relates to taxable, GST-free and input taxed supplies, a further allocation using the formula described below will be necessary.

54. We accept that different businesses may be able to allocate costs to different levels. For example, some entities may be able to use direct attribution on a product level while other entities will only be able to directly allocate to a business unit. Where you only perform allocation at a business unit level it may be necessary to use another method to then apportion other costs to the product level. That is, allocating to a business unit in some entities does not reflect whether the acquisition is used for making taxable, GST-free or input taxed supplies.

### Formula methods

55. The general formula calculates the extent (expressed as a percentage) to which an acquisition or importation is for a creditable

purpose in accordance with subsections 11-30(3) and 15-25(3). It applies the resulting percentage to the GST included in the price of acquisitions or importations, not previously accounted for under the direct attribution method.

56. When applying the general formula method (or an appropriate special formula) to apportion remaining input tax credits, you only apply the resulting percentage to those costs that you have not already attributed using the direct attribution method. This is to avoid double counting of input tax credits previously attributed.

### *Partial consideration*

57. The general formula assumes the taxpayer making the acquisition provides the full amount of the consideration. Therefore, where another entity provides part of the consideration, you must calculate the entitlement to input tax credits in accordance with the formula set out in subsection11-30(3) so as to reflect the 'extent of consideration' provided by the taxpayer. (Partial consideration is not relevant in relation to importations.)

### General formula

58. The formula approach attributes input tax credits based on a standard formula. You may use it to calculate the input tax credits for acquisitions or importations subject to GST which you have not allocated under the direct attribution approach. You may also use it if your existing accounting system does not support direct attribution. However, you should only use it after you have attempted to allocate acquisitions and importations directly.

59. The formula may take the following form:

**% Credit Allowed =**

$$\frac{\text{\$ Value of taxable and GST-free supplies}}{\text{\$ Value of total supplies (including input taxed supplies)}}$$

Calculated on a total revenue or net revenue basis. Value as used in the formula will be net revenue for financial supplies and gross revenue for non-financial supplies.

60. We have provided an example of the general formula and its components at paragraphs 93 to 110.

**Special formula methods**

61. Where the general formula is not suited to your particular business of a financial supply provider, then you may modify it to better reflect the your activities. An industry-based formula, such as the special allocation approach required for life insurance companies may be more appropriate. Another acceptable alternative would be to use the general formula as a basis but to use something other than dollar value as the basis for the formula.

62. These 'special' methods are explained in paragraphs 64 to 78 that follow. As stated at paragraph 36, where you use a special formula it must:

- be appropriate, reasonable and used consistently;
- accurately reflect the use of your acquisitions;
- be well documented and justifiable;
- give a more accurate reflection than the general formula.

63. Whatever method you choose, you should do the apportionment on a fair and reasonable basis in concurrence with the facts of the case.

*'Special allocation approach'*

64. Statutory obligations for financial reporting purposes are imposed on some financial supply providers such as life insurance providers. Methods you use to meet these obligations may form an appropriate basis of apportionment for GST purposes. One such approach, for example, could involve applying the special allocation approach as detailed in section 80 of *the Life Insurance Act 1995*.

*Example*

65. Life Insurance Co, in addition to selling life insurance, also sells general insurance. For the purposes of the Life *Insurance Act 1995*, Life Insurance Co must apportion the amount of income or outgoings relating to the two types of business and work out the amount that relates to the business of the statutory fund.

66. The apportionment basis chosen by Life Insurance Co is made equitably and according to generally accepted accounting principles. The Directors of the company obtain written advice from the appointed actuary that the basis of the proposed apportionment is appropriate.

67. Where an industry standard exists it may not be possible to use the exact method for GST purposes. In these circumstances, we will accept application of an amended version of the method to accommodate the GST regime. You should document clearly the rationale for any modifications to the standard.

68. You need not base the formula on the dollar value of transactions. Some other measure may be more appropriate depending on the nature of the business, e.g.:

- volume of sales;
- floor space;
- profit; or
- hours.

69. For example, a business unit that is responsible for the administrative functions of the organisation may not charge out to other units of the organisation and a different basis of allocation, such as salary, may be more appropriate.

*Indirect methods - input based method*

70. Another special method for apportioning input tax credits can be broadly categorised as being an *indirect* method such as a method based on inputs.

71. The indirect methods attempt to estimate the usage of acquisitions and importations for creditable purposes. Indirect methods use variables that are not directly identifiable with the use of the particular acquisition. For this reason they may not give an accurate measure of the creditable use of the acquisition or importation. However, they may provide a reasonable basis for the purpose of apportioning input tax credits.

72. Indirect methods may be appropriate in circumstances such as where there are overhead expenses or a large number of small acquisitions or importations and it is not cost effective to try to measure the use to which each separate acquisition or importation is put.

*Input based method*

73. Input based methods employ measures of some inputs to estimate the use of other inputs. These methods are only useful where input tax credits for some acquisitions or importations have already been allocated on a direct basis to making taxable or GST-free

supplies or to making input taxed supplies. The proportion of acquisitions already allocated on a direct basis should be sufficient to give some reliability to the calculation. You can use the proportion applied to making taxable or GST-free supplies out of the total allocated directly to apportion input tax credits in respect of those acquisitions with a mixed purpose, or where direct attribution was not possible.

74. This method will provide the most accurate results where the percentage of unallocated acquisitions relating to making taxable supplies is similar to the proportion of direct costs already directly allocated to making taxable supplies. Some examples of input based methods are:

- the cost of acquisitions used to make taxable or GST-free supplies relative to the total costs of all acquisitions; or
- input tax attributable to acquisitions used to make taxable or GST-free supplies relative to total input tax.

75. An input based method could be as follows:

*Example*

76. ZXC, a business that makes financial supplies in excess of the financial supply threshold, owns a two story building and is registered for GST. It rents out the ground floor to a business (a taxable supply). Some of the ZXC's enterprise costs are overheads which it cannot directly allocate specifically to making either taxable supplies or input taxed supplies. ZXC can directly allocate it's other costs to making either taxable supplies or input taxed supplies. ZXC could use an input based method as follows:

| INPUTS | | |
|---|---|---|
| Acquisitions - making taxable supplies | A | 400 |
| Acquisitions - making input taxed financial supplies | B | 600 |
| Acquisitions overheads | C | 200 |

$$\text{Extent of creditable purpose} = \frac{A}{A + B}$$

$$= \frac{400}{(400 + 600)}$$

$$\begin{array}{l}\text{Extent of creditable purpose} \\ \text{(expressed as a percentage)}\end{array} = 40\%$$

77. ZXC then applies the extent of creditable purpose of 40% to the overheads of $200 and claims input tax credits calculated on $80 of overheads as well as on the acquisitions for making taxable supplies of $400

78. You should exclude factors which may distort the results of indirect methods from the calculation. These include unusual supplies or acquisitions, for example substantial capital supplies or acquisitions.

**Periodic review/recalculation**

79. You may use one of the formulae or methods outlined above to calculate your entitlement to input tax credits on a monthly or quarterly basis. Some entities may prefer to calculate their average recovery rate on an annual or half yearly basis where it would be administratively difficult to perform the calculation regularly. We accept both approaches, although we regard performing the calculation on a more regular basis as giving the most accurate reflection of an entity’s recovery rate. However, an annual recalculation and balancing adjustment will apply when you conduct the calculation on an annual (or 6 monthly) basis.

*Annual recalculation*

80. If you use the general formula, or one of the special formula methods, then you should review the formula no less frequently than annually. You should base the review on your financial accounts for the immediately preceding year of income.

81. You will need to undertake the review of the formula at the end of the year to determine the accuracy of the method used to apportion input tax credits. The review will involve a comparison between the figures used in the formula based on the expected use and the actual use of the entity's acquisitions and importations.

82. This recalculation should occur not later than your first lodgment date for a tax period arising after three months from the end of that income year, or within such further period as the Commissioner may allow.

*Example*

83. ADB remits on a quarterly basis. For the income year ending 30 June 2001, ADB will need to recalculate the formula by 21 January 2002.

*Example*

84. HGI remits on a monthly basis. For the income year ending 30 June 2001, HGI will need to recalculate the formula by 21 November 2002.

85. You will use the resulting recalculated ratio as the basis for calculating the input tax credits you can claim in each subsequent GST return until the next recalculation. You should retain details of each annual recalculation.

*'Balancing adjustment'*

86. The ratio will also be used for a 'balancing adjustment' in relation to the input tax credits claimed in the GST returns lodged for the immediately preceding income year. The effect of this is that, input tax credits obtained during a particular income year, being based on the financial results of the previous income year, will be provisional pending the making of the balancing adjustment based on the actual financial results for that income year.

87. A 'balancing adjustment' will be made to account for any difference between the actual and estimated amount of input tax credits. This is to reflect the fact that you have incorrectly claimed input tax credits, having either claimed more credits than you were actually entitled to or having not claimed the full input tax credits to which you were entitled.

88. You should make the balancing adjustment in your first GST return for a tax period after three months from the end of that income year.

89. When you use the formula with real time information, i.e., you recalculate the formula monthly or up to 3 monthly, no balancing adjustment will be necessary. No annual recalculation is required, as the formula being used will be current. However, significant

variations will necessitate a review of the estimates or variables used in the formula.

90. You should review the components contained in the formula used to calculate your input tax credit recovery ratio when circumstances dictate or when the criteria on which the formula is based change.

### Record keeping relating to apportionment methods

91. If you make a creditable acquisition or creditable importation you must keep records that show and explain all transactions and other acts you engage in that are relevant to that acquisition or importation. You must retain those records for at least 5 years after the completion of the transaction or acts to which they relate. The records must be such as to enable your liability under the GST Act to be readily ascertained.[3]

92. It follows that you should retain records relating to the calculation and apportionment of input tax credits, and how you arrived at your net amount. Records you normally keep as part of carrying on your enterprise should be sufficient to support the appropriate method. Where this is not the case, you may need to keep additional records.

### An Example of the General Formula

*Components of the General Formula*

93. We have outlined an example of the general formula and the components that you may include (as is appropriate) below. We have provided explanations of some of these components in subsequent paragraphs.

Input Tax Credit Recovery Ratio =

$$\frac{\text{Revenue* from} \\ \text{Taxable and GST-free supplies}}{\text{Revenue* from total supplies} \\ \text{(including input taxed supplies)}}$$

* ‘Revenue’ is net revenue for financial supplies and gross revenue for non-financial supplies.

[3] Section 70 of the *Taxation Administration Act 1953.*

**Net revenue from taxable and GST-free supplies**

| | |
|---|---|
| *GST-free Financial Services Revenues* | |
| Forex & Derivatives – Actual Margin **x** sample GST-free percentage | A |
| Net Interest from Non Residents | B |
| Gross Fees & Commissions from Non Residents – Actual | C |
| Other Net/Margins Revenue from Non Residents | D |
| GST-free Life Insurance supplies – Net value added | E |
| Other GST-free grandfathered financial supplies | F |
| *Revenue from taxable supplies* | |
| Gross Fees & Commissions (eg, Safe Custody Fees) from non-financial supplies – Actual | G |
| Other income – Net | H |

**Net revenue from taxable and GST-free supplies** =

A+B+C+D+E+F+G+H

**Net revenue from total supplies**

| | |
|---|---|
| Forex & Derivatives Margins – Actual margin | I |
| Net Interest | J |
| Gross Fees & Commissions from financial services – Actual | K |
| Other Net/Margins Revenue from Financial Services | L |
| Life Insurance – Net Value Added | M |
| Other income – Net | N |

**Net revenue from total supplies** = I+J+K+L+M+N

*Formula components that are GST-exclusive*

Components A – N are included on a GST-exclusive basis.

*Net revenues*

All components in the general formula are net revenues except for components C, G and K. These components are gross amounts.

*Exclusions*

94. The general formula aims to apportion input tax credits using trading income as a basis of determining the recovery rate. Certain items are excluded from the numerator and denominator of the ratio of the general formula. These items are abnormal revenue items and are excluded as they might otherwise distort the calculation of an accurate ratio.

95. The denominator and numerator should exclude certain items even if they would otherwise come within the component e.g., component H is 'other income'. These include:

- dividends received from wholly owned companies, except where the company is part of a financing structure, for example, a special purpose company acquired by a bank to facilitate a transaction for a customer of the bank;
- dividends from investments and financing structures are included because of the likelihood of a nexus between these and the inputs of a bank;
- capital receipts from asset sales, for example the sale of a head office building, whether or not the sale is a taxable supply; and
- amounts that have already been directly allocated.

*Sample procedures*

96. A sample is required for calculating component A of the numerator in the general formula. The sample must be representative of transactions likely to occur for the full period. We will accept the sample procedures set out in the following paragraphs.

97. The initial sample will take place over the period from 1 June until 31 July 2000 and will cover a continuous period of one month.

98. The sample will cover all the following transaction types:

- foreign exchange transactions (whether spot or forward exchange transactions);
- sales of money market securities;
- interest rate swaps;
- currency rate swaps; and
- other financial derivative transactions (including futures, options and other hedges).

99. The sample will identify the following attributes of all the transactions:

- residence of counterparty;
- dollar amount of the foreign exchange transactions;
- dollar amount of the initial exchange or the final exchange of currency rate swap transactions; and
- notional principal amount of interest rate swap and other financial derivative transactions.

100. A sample should not include transactions where the entity is acting as a financial supply facilitator. We will review the frequency of future samples to be taken. We anticipate that a review will be required every two years.

101. There are three options for applying the sample percentage:

(i) product sample percentage times product gross margin;

(ii) aggregate sample percentage times treasury gross margin; and

(iii) weighted average sample percentage times treasury gross margin.

102. We expect that where the financial supply provider's systems support the use of option (i), then provider would generally use option (i). However, we will accept the use of the most practicable of these options on the basis of the particular entity's accounting systems, provided that the option is also reasonable and appropriate in the circumstances.

103. However, we acknowledge that the use of option (i) is more volatile. If option (i) causes a negative amount the entity must seek agreement from the Commissioner as to an alternative.

104. You must use the method chosen consistently from year to year. You cannot change from the initial method chosen without the agreement of the Commissioner.

### Components explained

*Actual Margin components A, I, D and L*

105. Revenues in this item are those from forex and derivative 'trading' activities. The method used for calculating margins should be the methods used in your accounting records. Revenues from hedging derivatives, being typically accounted for against the underlying product being hedged on an accrual basis (by a business

unit), will generally be included in the interest income/expense component of the formula.

106. In some years, the actual margin from these activities may be negative. If you use actual margin, this may contribute to considerable volatility in the percentage calculated under the formula. In some years the margin may be negative. If this is the case, you should approach the Commissioner to agree on an alternative approach.

*Net value added for life insurance products*

107. Certain life insurance supplies may be GST-free under section 13 of the *A New Tax System (Goods and Services Tax Transition) Act 1999*. Net Value Added for products provided by Life Insurers (including annuities) is calculated on the basis of 'Explicit Charges', 'Investment Margins' and 'Premium Loadings'. Explicit Charges do not include premiums, but include situations where the Life Insurer charges an explicit fee, for example, for some minor service provided to a particular policy holder, or explicit charges made to an investment account or investment-linked contracts where these are charged and invoiced to the policy holder.

108. Investment Margins and Premium Loadings are the value added that remains after increases in liabilities are deducted from investment income and premium income. Investment Margins represent the margin on investment income required to cover the Life Insurer's costs, including rent, plant depreciation, labour and shareholders' profit (if there are shareholders) in respect of the investment income.

109. Premium Loadings represent the loading on the benefit premium paid by the policy holder and are used to cover the Life Insurer's costs, including agents' commissions, rent, plant depreciation, overheads and shareholders' profits.

*Component F*

110. This component includes those financial supplies that may be GST-free under section 13 of the *A New Tax System (Goods and Services Tax Transition) Act 1999*.

**Reduced input tax credits and apportionment methods**

111. As a financial supply provider, you may make acquisitions that are eligible for reduced input tax credits under Division 70. You will also make other acquisitions that are not eligible for reduced input tax

credits but relate to making taxable and input taxed supplies so that you are entitled to partial input tax credits.

112. Acquisitions that give rise to reduced input tax credits are referred to as reduced credit acquisitions and are set out in regulation 70-2 of the GST Regulations. When you make a reduced credit acquisition, Division 70 provides a formula to work out your input tax credit. Under this formula, a partial input tax credit will be available, notwithstanding that you use the acquisition to make input taxed financial supplies. Division 70 operates to work out a percentage that combines the proportion of input tax credit you are entitled to, by taking into account the extent to which you are entitled to an input tax credit under both Division 11 and Division 70.

113. To work out the extent to which you are entitled to an input tax credit under Division 11 and Division 70 for a reduced credit acquisition, you use the apportionment methodologies outlined above.

114. For other acquisitions you make, that is, acquisitions that are not reduced credit acquisitions, you use the apportionment methodologies to work out the extent to which you used the acquisition for a creditable purpose. You will then apply the formula at Division 11 to work out your entitlement to input tax credits.

115. As set out in the paragraphs of this Ruling that deal with choosing an apportionment methodology (paragraphs 44 to 47), the method that will be the most appropriate will depend on current accounting systems in place and the ability of your entity to cost allocate.

### *Inter-relationship of Apportionment Methodology and Division 70*

116. We consider that you should use the Division 70 method first, as for many financial supply providers this will be where most of the input tax credits arise. Division 11 will then be used to work out your input tax credits that relate to acquisitions not covered by Division 70.

117. When working out how to apportion your input tax credits we recommend the following procedure:

> **Step 1**: identify those supplies that are eligible for a reduced input tax credit. Some of these may relate to making GST-free or taxable supplies as well as input taxed financial supplies. Work out the extent to which you use them for making each type of supply (i.e., the Division 70 creditable purpose and the extent to which they are creditable under Division 11) using the apportionment methodologies described in the Ruling.
>
> **Step 2:** identify those acquisitions or importations (not included at Step 1) that relate to making taxable supplies or

> GST-free supplies and input taxed supplies. Apply apportionment rules.
>
> **Step 3:** identify those acquisitions or importations (not already included under Step 1) that relate purely to making input taxed supplies.

118. There is a degree of overlap in the function and impact of an apportionment methodology and the Division 70 formula and entities will need a framework for coordinating the operation of the two systems.

119. You are able to use both the general apportionment methods and Division 70. However, you are not able to apply the Division 70 formula to all acquisitions used to make financial supplies. It only applies to those reduced credit acquisitions listed in the regulations.

120. The following approach coordinates the operation of the two systems:

> **Step A**: having worked out the extent to which the reduced credit acquisition is for a creditable purpose and the extent to which it relates to making input taxed financial supplies, apply Division 70 in respect of the prescribed categories of acquisitions.
>
> **Step B**: apply apportionment methodology to all other expenses (as identified using the process above).

121. Once you have applied Division 70 to work out the input tax credit available on an acquisition that falls within that division, you do not have to make any further calculation in respect of that acquisition. That is, you do not reapportion the expense through the direct attribution approach or the general formula.

122. You work out the extent to which the acquisition is acquired or applied for a creditable purpose using the following formula:

$$\begin{array}{c}\text{Extent of}\\\text{creditable}\\\text{purpose}\end{array} + \left\{ \begin{array}{c}\text{Extent of}\\\text{Division 70}\\\text{creditable}\\\text{purpose}\end{array} \times \begin{array}{c}\text{Prescribed}\\\text{credit}\\\text{reduction rate}\\\text{(currently}\\\text{75\%)}\end{array} \right\}$$

Where:

**Extent of creditable purpose** is the extent to which the purpose for which the acquisition was applied or acquired was a creditable purpose otherwise than because of Division 70, expressed as a percentage.

**Extent of Division 70 creditable purpose** is the extent to which the purpose for which the acquisition was applied or acquired was a creditable purpose because of Division 70, expressed as a percentage.

**Prescribed credit reduction rate** is the reduced input tax credit percentage prescribed for an acquisition of that kind (currently 75%).

*Example 1*

123. Examples of how Division 70 operates, together with the interaction between it and the formula are provided below.

124. Little Bank makes a reduced credit acquisition of $110,000, wholly for the purposes of carrying on its enterprise. The acquisition is wholly for a Division 70 creditable purpose. Little Bank is entitled to a reduced input tax credit calculated as a prescribed percentage of the GST payable, e.g., $10,000 x 75%.

*Example 2*

125. Medium Financial Supply Provider (MFSP) makes a reduced credit acquisition. Using the direct attribution method MFSP works out that the acquisition is used 45% for making financial supplies and 55% for the purpose of making taxable supplies. The percentage credit reduction prescribed in the regulations is 75%.

126. The extent to which MFSP makes the acquisition for a creditable purpose is:

55% + (45% x 75%) = 88.75%

This percentage is then applied in the formula in Division 11-30. Had the acquisition been fully creditable the full input tax credit (assuming MFSP provided all the consideration) would have been $10,000.

MFSP reduced input tax credit would be $8,875 .

## Examples

### Example 1

***Allocation of Costs Down to a Business or Activity***

127. ABC Bank has two internal information technology areas. These areas perform processing and support activities and do not make supplies to external third parties. One serves only the funds management part of ABC Bank while the other serves the rest of the Bank's business operations but not the funds management business.

128. ABC Bank decides that it would be inaccurate to spread the GST incurred by these IT functions evenly across the whole ABC

Group. Instead ABC Bank wants to attribute the GST paid and the resulting input tax credits in a commercially realistic way to business areas of ABC Bank that make external supplies.

129. ABC Bank decides to attribute the GST incurred by these support or processing activities to the areas that make external sales as closely as ABC Bank's management accounting systems allow. It allocates costs incurred by the technology area dealing with funds management to the funds management business. It allocates costs incurred by the area dealing with ABC Bank's other activities to the rest of ABC Bank, excluding the funds management business. ABC attributes the GST on the basis of its internal charging mechanisms.

### Example 2

***Selection of Basis for Apportionment Ratio***

130. Corporate Treasury acquires stationery items and a new photocopier and incurs GST on these items. Corporate Treasury produces 50% GST-free and 50% input taxed supplies (calculated on a dollar turnover basis).

131. If a dollar turnover basis is used, the ratio for claiming the input tax credit would be 50%. If a number of transactions basis is used the ratio is likely to be different.

*Choice of Method*

132. Corporate Treasury's existing management accounting records are as follows:

| Measurement Method | GST Free<br>Overseas Clients<br>(%) | Input Taxed<br>Domestic Clients<br>(%) | Comment |
|---|---|---|---|
| Dollar Turnover | 50 | 50 | Based on dollar turnover (fees and margin) |
| Number of Transactions | 65 | 35 | Based on the number of transactions for domestic and offshore counter parties |
| Headcount | 40 | 60 | Based on the number of "direct" staff plus proportion of "indirect" staff (may be pure headcount or salary cost) |

133. It is clear that the highest ratio of input tax recovery will occur if the number of transactions basis is used for this business unit. Provided Corporate Treasury does not manipulate transaction numbers, this is an acceptable method of calculating the apportionment ratio.

134. If manipulation takes place (e.g., if Corporate Treasury 'churns' exported transactions to generate a higher ratio of GST-free supplies) the GST anti-avoidance rules are likely to have application.

135. The method chosen by Corporate Treasury conforms with Australian Accounting Standards and it keeps records of the apportionment decisions it makes.

## Definitions

### Cost allocation

136. Cost allocation (cost accounting) describes a method of accounting used to attribute direct and overhead costs to a source of income or business activity.

### Creditable acquisition

137. Creditable acquisition refers to an acquisition you acquire for use in your enterprise. You are entitled to an input tax credit for the GST component included in the price of these acquisitions. Under section 11-5, you make a creditable acquisition to the extent that:

- you acquire anything solely or partly for a creditable purpose; and
- the supply of the thing to you is a taxable supply; and
- you provide, or are liable to provide, consideration for the supply; and
- you are registered or required to be registered.

### Creditable importation

138. Creditable importation refers to goods you import for use in your enterprise. You are entitled to an input tax credit for the GST component included in the price of these importations. Under section 15-5, you make a creditable importation to the extent that:

- you import the goods solely or partly for a creditable purpose; and
- the importation is a taxable importation; and

- you are registered or required to be registered.

### Creditable purpose

139. Creditable purpose has the meaning given by sections 11-15 and 15-10. Creditable purpose refers to where a thing is acquired or imported by an entity for the purpose of carrying on its enterprise. However, an acquisition or importation is not for a creditable purpose to the extent that it is acquired or imported for making input taxed supplies or is for a private or domestic purpose.

### Direct attribution

140. Direct attribution involves:

- matching specific acquisitions and importations directly with supplies; and
- using an accounting system, such as activity based costing or any another internal cost allocation system, to allocate costs to a specific transaction, product line, cost or profit centre, business division or function.

### Financial supply

141. Financial supply financial supplies are supplies that are interests in financial products as set out in section 40-5 of the GST Act and in regulation 40-13 of the GST regulations. Examples include maintaining and operating cheque and savings accounts for account holders; lending, including maintaining and discharging loans and mortgages; life insurance contracts; conversion of foreign currency; futures contracts; commodity derivatives; options; and shares or debentures.

### Financial supply provider

142. Financial supply provider Under regulation 40-10 of the GST Regulations an entity who in relation to the supply of an interest that was:

(a) immediately before the supply, the property of the entity; or

(b) created by the entity in making the supply;

is the ***financial supply provider*** of the interest.

Examples of these interests under paragraph (a) include sale of a share or bond, and assignment of rights under a derivative. Examples of interests under paragraph (b) include issue of a share or bond or entry into a derivative.

### Financial supply facilitator

143. Financial supply facilitator Under regulation 40-11 of the GST Regulations a financial supply facilitator, in relation to supply of an interest is an entity facilitating the supply of the interest for a financial supply provider. Financial products supplied by a financial supply facilitator are not financial supplies. However, a supply of an interest under regulation 40-13 facilitated by a financial supply facilitator is a financial supply by the financial supply provider.

### Financial supply threshold

144. Financial supply threshold (also known as the *de minimis* threshold) is the lesser of:

- $50,000 (or such other amount specified in the regulations); or
- 5% of your annual turnover (treating supplies that are input taxed financial supplies as part of your annual turnover).

This term is not used in the GST Act but is used for convenience of reference in this and other GST rulings to describe the conditions contained in subsections 11-15(4) and 15-10(4).[4]

### General formula

145. General formula attributes input tax credits and calculates the ratio of taxable and GST-free supplies as a proportion of total supplies, including input taxed supplies. It may be used to calculate the input tax credits for acquisitions or importations subject to GST which have not been allocated under the direct attribution approach. The formula may take the following form:

$$\frac{\text{\$ Value of taxable and GST-free* supplies}}{\text{\$ Value of total supplies (including input taxed supplies)*}}$$

[4] Proposed amendment contained in the A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999. This Bill received Royal Assent on 22 December 1999.

### GST Regulations

146. A New Tax System (Goods and Services Tax) Regulations 1999 (No 245 of 1999).

### GST Return

147. GST Return means the approved form referred to at section 31-15 and is used for accounting for the GST you have paid and collected. It forms a part of your ***Business Activity Statement*** ('BAS') which is also used for accounting for some other taxes your business may pay, such as income tax instalments, fringe benefits tax instalments, luxury car tax, and wine equalisation tax.

### Gross

148. Gross the whole or total amount of something before any deductions have been made. For example, gross interest is the interest on an investment before any tax is deducted.

### Input tax credits

149. Input tax credits refers to the credit you are entitled to claim for the GST included in the price you pay for an acquisition or importation that you use in your enterprise. However, you are not entitled to input tax credits to the extent the acquisition or importation is used to make input taxed supplies or is for a private or domestic purpose.

### Input taxed supply

150. Input taxed supply means a supply that is input taxed under Division 40, such as a financial supply. If a supply is input taxed you do not pay GST on the supply but you are not entitled to an input tax credit for anything acquired or imported to make the supply.

### Interest

151. Interest the charge on borrowed money or the return earned on funds out on loan or invested.

### Net

152. Net the amount after charges and deductions. For example, net income is the amount after deductions for income tax. A reference to

net profit would mean gross profit less all expenses such as cost of goods sold, selling expenses, tax and interest on borrowings.

### Reduced credit acquisitions

153. Reduced credit acquisitions listed in the A New Tax System (Goods and Services Tax) Regulations ('the GST regulations') that, when acquired by a financial supply provider, creates an entitlement to a reduced input tax credit. Subregulation 70-2(2) contains an exhaustive list of the acquisitions that are reduced credit acquisitions.

### Reduced input tax credits

154. Reduced input tax credits an input tax credit, currently set at the rate of 75%, that can be claimed (subject to the normal qualifications under section 11-5) for certain acquisitions listed in the GST regulations as reduced credit acquisitions. The entitlement to the credit arises under section 70-5.

### Taxable importation

155. Taxable importation under section 13-5 refers to an importation of goods into Australia but only to the extent it is not a non-taxable importation. Supplies that are non-taxable importations are set out in Part 3-2 of the Act and also include a supply that would have been GST-free or input taxed if supplied in Australia.

### Taxable supply

156. Taxable supply has the meaning given by section 9-5 which provides that (except to the extent it is GST-free or input taxed) a supply you make is a taxable supply if:

- the supply is for consideration; and
- the supply is made in the course or furtherance of an enterprise that you carry on; and
- the supply is connected with Australia; and
- you are registered, or required to be registered.

## Your comments

157. If you wish to comment on this draft Ruling, please send your comments promptly by **18 February 2000** to:

| | |
|---|---|
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| Address | GST Law & Interpretation<br>GPO Box 900<br>CANBERRA ACT 2601. |

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**Commissioner of Taxation**
24 December 1999

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

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